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INVESTMENT TECHNOLOGY & ENTERPRISE DEVELOPMENT

The United Nations Conference on Trade and Development, UNCTAD, publishes annually the **World Investment Report,** which surveys the activities of multinational companies. These companies made foreign direct investments of a record US$400 billion last year and the total is expected to rise this year despite the repercussions of the Asian economic crisis. Karl Sauvant from the Division on Investment Technology and Enterprise Development of UNCTAD discusses the findings of this year's **World Investment Report**.

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ANNOUNCER: From United Nations Headquarters in New York, this is **World Chronicle**, an unedited interview programme about major global issues.

Here now to introduce our guest is the host of today's **World Chronicle**.

WILLIAMS: I'm Ian Williams, sitting in for Michael Littlejohns, and this is **World Chronicle**.

In most countries, economic liberalization continues to proceed at a fast pace. The flow of foreign direct investments has reached record levels but have the most needy really benefited from the increase of worldwide production? And with the current world economic crises, how long can global economic growth last?

Our guest today is Karl Sauvant from the Division on Investment Technology and Enterprise Development of the United Nations Conference on Trade and Development, UNCTAD. Mr. Sauvant is responsible for the publication of the World Investment Report which tracks the flow of international capital.

Joining me to talk with Mr. Sauvant is Ricardo Alday from the Mexican News Agency, NOTIMEX, and Farhan Haq of *Inter Press Service*.

Mr. Sauvant, welcome to **World Chronicle**.

WILLIAMS: We have been tracking the World Investment Report for several years and at one time of course the United Nations thought that foreign direct investment was a very suspicious and dangerous thing, then it decided that it was a wonderful thing, and many people in the last year or so with the Asian economic crisis began to ask questions about it again. Is it really wise for the world to have this undiluted floods of capital going in and out of countries on short notice? And reading your report you seem very optimistic but you don't seem desperately concerned about the Asian economic crisis. While many people drew lessons from this that maybe there should be more controls on capital you don't seem to be suggesting this at all in the report.

SAUVANT: Well that's correct and I think the reason is that when you look at international capital flows you really have to distinguish between long-term flows like foreign direct investment on the one hand, and short-term flows like portfolio investment and commercial lending on the other hand. These are two types of flows which behave

differently because they have different motivations. Foreign direct investment is normally made with a long-term time horizon in mind and it involves actual commitment of investors to the country in terms of building up production facilities and integrating them into international networks. Portfolio investment on the other hand, is being made for short-term gain and with short-term considerations in mind, and indeed the behaviour of the two types of flows in Asia has been different. If you look at the flows in 1997 you could see that portfolio investment and commercial bank lending went into the negative by the end of the year, but foreign direct investment flows at the end of the year remained at the same level as in 1996 and we expect that the same thing will apply in 1997. So what you have actually is, you have two types of flows which behave differently and therefore presumably the policy responses are different as well. And while countries are actually discussing the possibility of imposing, for instance, controls on short-term capital flows, the countries of the region have actually doubled their efforts in terms of attracting long-term, more stable, foreign direct investment.

ALDAY: Do you think that will be a wise move, I mean, to impose controls on foreign direct investment? When does it work and when does it not, because for a developing country which badly needs foreign direct investment, there are a number of mixed signals with this global volatility in financial markets, so when is it safe and when is it not to impose controls?

SAUVANT: I think the whole discussion of controls as far as capital movements are concerned focuses largely, if not entirely, on the question of short-term capital movements. The whole question of foreign direct investment flows is being kept separate and as I said a moment ago, I think countries even are making extra efforts to attract foreign direct investment. That is certainly true for the five most affected countries in Asia which, in addition to making their own individual efforts to attract foreign direct investment actually have now established an Asian investment area where together they hope to become more attractive to foreign direct investors.

FARHAN: Isn't there a danger, however, that if some countries, for example Malaysia, try very hard to reverse the flow of liberalization in an effort to keep more

control over the portfolio flows that they may discourage foreign direct investment overall by creating a sort of climate where the investors in general feel nervous?. It just struck me, particularly if Malaysia's effort were successful, many more countries might actually have a certain backlash against liberalization measures in general.

SAUVANT: Well, I think this is certainly something one has to keep an eye on but what is crucial, I think, is whether countries are actually, in dealing with short-term capital flows, undertaking anything which also would affect foreign long-term capital flows. And countries which have dealt with short-term capital flows in the past, including other countries in the region, certainly have seen at the same time a boom in foreign direct investment flows – I am thinking for instance of China. So I think the two are not necessarily connected in the sense that if you try to manage short-term capital flows it does not necessarily mean that there is a negative effect on foreign direct investment flows.

WILLIAMS: Can the two actually be distinguished so carefully? Part of the problem in the Asian crisis was people were lending to banks which were then making portfolio investments and when they went down the tubes, the banks were about to follow until the IMF bailed them out. And so this distinction is intellectually satisfying but in the real world does it make that much difference?

SAUVANT: Well, there are of course boundary lines between the two but these are to a certain extent blurred. You're right, after all there are some portfolio flows, portfolio investments which are being made with a longer term time horizon in mind. If you think for instance of the venture funds they might be for three, four, five years, on the other hand you might well have foreign direct investment which is actually divested fairly rapidly in the context of mergers and acquisition. But having said that... the boundary lines between the two are certainly blurred to a certain extent, but the basic underlying motivations are different and the basic behaviour is different and that is expressed precisely in the data which you see. As I mentioned before, portfolio inflows have reversed as far as the five most affected countries are concerned, but foreign direct investment flows have remained stable and they are expected to remain stable in 1998 as well.

ALDAY: Do you think that the demand by many developing countries to

establish a certain kind of international regulation to these flows is feasible given the current political circumstances in the world?

SAUVANT: Well, you are touching in an area which is really not being addressed in the World Investment Report and which is also not my area of core competency. We are dealing in the report only with foreign direct investment issues. We have another report, the Trade and Development Report, which explicitly addresses these questions and maybe this is something you might want to take up in a separate exercise of this kind and explore it further.

ALDAY: But as an expert in the field do you believe that this will be healthy or unhealthy for the current environment of the financial markets?

SAUVANT: Well, when it comes to foreign direct investment flows I think the key issue is the determinants which you find in individual countries in terms of being attractive to foreign direct investment, to long-term foreign direct investors. The regulatory framework as such is an enabling framework and of course if you have an enabling framework then investors may look for other investment determinants on the basis of which they then decide whether or not to go ahead. In fact, the World Investment Report 1998 paid special attention to the question of host country determinants and what makes a country particularly attractive to foreign investors, direct investors.

FARHAN: Now this year's report suggests that after six years of a sort of investment boom China will experience a sort of tapering off of its own foreign direct investment. Given that the Asian economies are already reeling what sort of an effect is that going to have in terms of the prospects for development in Asia in the coming year or the next several years?

SAUVANT: Well, it's actually an interesting observation. Asia has been the most attractive region for foreign direct investment in the past. In 1997, however, Latin America was the region which actually showed the best performance in increasing foreign direct investment flows. Now, within Asia the dominant country is China and China, as you pointed out, is expected to see lower investment inflows in 1998 compared to 1997. 1997 they were about forty-five billion, for 1998 our estimation is about forty-one billion. Now,

mind you, China is not one of the five most affected countries. There are other factors at work which explain that you have a tapering off of foreign direct investment into China. This does not necessarily have negative effects on the rest of Asia. I mean this is, foreign direct investment inflows into China contribute to the building up of the Chinese economy and to make Chinese enterprises located in China more competitive in the world market. But it does not necessarily have an effect on the rest of Asia. On the other hand, China itself and inflows into China may be affected by what is happening in the rest of Asia.

WILLIAMS: There is that sort of an economic basket case which we haven't mentioned so far of course. In the case of Russia where all of the foreign direct investment seems to have been siphoned off into Swiss bank accounts almost immediately, in fact more money seems to be leaving the country that entering. This is obviously, partly at least, the consequence of the liberalization of capital flows there, and can you comment on how the disastrous economic situation in Russia is explained by this sort of fairly rosy outlook you have on foreign direct investment in the report?

SAUVANT: Well, I think again underlying is you have to distinguish between various types of capital flows. Now you introduced an additional capital flow, flight capital. Again, this report, the World Investment Report, deals with direct investment. Direct investment in Russia in 1997 had increased considerably. We expect that it remains in 1998 at approximately the same level. The reason is that the crisis in Russia really only hit towards the end of the year and indeed that long-term investment projects are also not switched off from one day to the other. What will happen in 1999 is another matter which we will have to see, but in any event foreign investors, direct investors are looking at the Russian market not with the idea in mind can we make a profit tomorrow but is this a market which is likely to be important in three, four, five, ten years from now, and then make the decisions accordingly. And I think all indications are that Russia as a market will be important, and will be more important in the years ahead and therefore direct investors want to have a foot in that market, want to expand.

WILLIAMS: Isn't it more of a toe than a foot at the moment? It would be a brave investor who would risk a whole foot in now.

SAUVANT: That's correct, it's a toe at the moment, and it has been a toe in the past. And the same thing applies to a certain extent for other central and eastern European countries as well, implying that once the economic situation has stabilized in all of them, and in a number of countries it has, they will become much more attractive for foreign direct investors.

ALDAY: What about Africa?

SAUVANT: Well, Africa is a region which has experienced an increase in investment flows if you look at the average of let's say, 1995, 1996 and 1997 compared to the early nineties. But it has not increased at the same rate as other developing countries or other developing country regions. But I think the key thing about Africa and the report tries to make that very clear, is that you have to differentiate. You cannot put all the countries of Africa into one basket so to speak. And we have identified a number of countries which are front runners in the sense that they perform better, not only on the average of Africa but rather on the average of the developing countries. And therefore the message is for foreign direct investors, you should not look at Africa as a whole, you should look at each country, you should look at each industry by itself and decide whether or not a direct investment is in your interest or not.

WILLIAMS: This is **World Chronicle**, our guest is Karl Sauvant from the Division on Investment Technology and Enterprise Development of the United Nations Conference on Trade and Development, also known as UNCTAD.

FARHAN: Well, speaking of Africa, the report points out that there are about seven countries that are very good performers - Botswana, Mozambique - what are the real factors that put them ahead of the rest of the class, so to speak? Is it simply an effort to get behind political, military crises such as those that have affected the central African countries or is there a more structural reason why so many, why about 50 countries almost in Africa have lagged behind for so long?

SAUVANT: Well, I think that we have to be careful in terms of defining lagged behind. While it is correct that Africa in absolute terms is getting little foreign direct investment – five, six billion dollars – you should keep in mind that as far as the

importance of that investment for the economies are concerned the picture is different. In other words, if you take foreign direct investment inflows as a percentage of GDP or Gross Domestic Capital information, Africa is actually not lagging that far behind. That Africa gets little investment to a certain extent simply reflects that this is a small economy, to put it very crudely. You wouldn't expect Luxembourg to get as much foreign direct investment as the United States for a number of reasons. So I think the first point is that indeed, in terms of the direct investment that Africa obtains, it is quite important for the countries involved in terms of sharing gross domestic capital information. Now why are some countries more successful than others, and as you mentioned, we identified a number – Botswana, Equatorial Guinea, Ghana, Mozambique, Namibia, Tunisia and Uganda? I think the first point is, as you already pointed out, it's political and economic stability, it's growth, these are the principal basic determinants of foreign direct investment. It's in some cases also access to larger markets – for instance in the case of Tunisia access to the European market. It's privatization programmes which play a role not only in Africa but also for instance in Latin America and it is, I think, an effort on the part of these countries, as of other African countries, to improve the regulatory framework for foreign direct investment. And these factors together I think have made these countries front runners in Africa.

WILLIAMS: Just across the South Atlantic from Africa, of course, is Brazil, which has been a test case almost over the last few years, could you explain what happened there because once again this was a country that was booming – lots of foreign direct investment, relative political stability – and then suddenly somebody decided to reverse the flow and where billions were coming in, suddenly two billion dollars a day were rushing out again.

SAUVANT: Again, I have to come back to the basic point that you have to distinguish between capital flows. Latin America, as I mentioned earlier, in 1997 saw the largest increase in terms of foreign direct investment inflows to some 56 billion dollars. Within the region, in 1997, Brazil has been the star performer, the champion so to speak with about 16 billion followed by Mexico with about 12 billion. We expect that Brazil in

1998 will have more than it received in 1997. Some of it, a good part of it is related to privatization programmes, but it is independent of what is happening as far as short-term capital flows are concerned. Now having said that, of course if the economic situation should deteriorate in Brazil, or for that matter in any other country, that of course has an effect on direct foreign investment flows as it has an effect on domestic flows. So I mean the underlying determinant for foreign direct investment is, of course, also one of the principal underlying determinants is the performance of the economy as a whole.

WILLIAMS: Is it the real performance or the perceived importance?

SAUVANT: It's a combination of both. Yes, it's a real performance, it is also the real performance not only today but as expected in several years and of course, that has always been coloured by perception. But to give you an example, just by way of example to return to Asia, BMW has announced a 50 million dollar investment, Greenfield investment in Thailand, two or three months ago. Now this is not based on the performance of Thailand today, it is based on the longer term performance that one expects in Thailand, or for that matter in southeast Asia. And I think that this is exactly what makes the difference between direct investors who want to build up strategic positions, who want to be able to serve the market, who want to be competitive internationally, vis-a-vis their own rivals, that indeed some of them see actually now an opportunity in Asia to expand and invest.

ALDAY: Mr. Sauvant, I'm looking forward and I'm wondering what's going to happen if this trend continues policywise, particularly in developing countries? What is going to happen once everybody offers the same conditions to investors? What's going to happen, what are the investors going to look for, what are the guarantees that that country must put in place?

SAUVANT: Well, that's a very important question because what you certainly see is a trend in the framework of which virtually all countries, and I mean all countries, are liberalizing their foreign direct investment regimes. There is not one country that hasn't liberalized in one way or the other a good part of its foreign direct investment regimes. We have tracked that trend since about 1991. We have identified approximately 750

policy changes during that period in the foreign direct investment framework and over 90 percent were in the direction of creating a more favourable climate for foreign direct investment. Now in addition it also implies, as you pointed out, that direct investment frameworks are becoming more similar. Now what do countries do in response to that because then obviously the regulatory framework is no longer a factor which is a major attracting factor. Well one, they become more active in terms of attracting investors. You have now, practically every country has an investment promotion agency, you have more efforts to service investors who are already there and you try to make a difference in that respect, you court for investors in other words. But all of that, I think, leads to something else which is much more important. The more the regulatory frameworks become similar the more the underlying economic determinants become important. After all the regulatory framework is an enabling framework and then companies have to see whether or not they would actually invest, whether or not it is possible to make a profit in the country. And there I think the World Investment Report 1998 is pointing out that the investment determinants are actually shifting from the regulatory framework and what we call business facilitation towards economic determinants, and within these economic determinants away from the traditional natural resources, low-cost labour type factors towards what we call created assets. Namely, skill-intensive assets, science and technology infrastructures and things like that.

WILLIAMS: Isn't that sort of a chicken and egg?... If the investment that creates those to begin with is there, and if you don't get the investment you don't create them.

SAUVANT: Yes, it's a chicken and egg situation and indeed, what you see is that foreign direct investors are attracted by countries which are performing well but at the same time they are also investing in countries which are not necessarily doing well because, after all, there is a market to serve, there may be natural resources to work with, there may be some skilled labour you can involve in an integrated international production network. But you are absolutely right there is an inter-relationship. Growth attracts foreign direct investment and foreign direct investment contributes to growth and it's this virtuous cycle, of course, that countries would want to bring about.

FARHAN: Now, is everything part of that virtuous cycle? For example you suggest in the report that quite a bit of investment activities, not simply investment geared towards production but investment that is forged between mergers and acquisitions. How much long-term benefit does that sort of activity bring to the developing world?

SAUVANT: Well, the question of mergers and acquisition is more a question of the entry strategy. In fact, in most developed countries the principal way that a foreign company establishes itself is through a merger and acquistion. But that merger and acquisition still results in production. In fact, the assets acquired may then well be integrated into a broader network. I think what you are pointing out is that not all foreign direct investment increases necessarily the capital stock of the country, that is correct. On the other hand, it may well nevertheless bring technology, bring access to markets, bring better management methods and therefore increase the productivity of the facilities involved. But you are absolutely right, not every foreign direct investment increases the capital stock of the countries involved.

WILLIAMS: By way of winding up, three or four months ago in mid-summer of 1998, it looked very much as though we were on the verge of a great slump, a big crash on the 1930's scale but for the time being that seems to have been averted. Do you ever think that was a real possibility and is it still likely to happen and would it be as a result of your investment trends when it does?

SAUVANT: Well, I think certainly policy makers world-wide, and in particular in the principal economies, have to keep a very close eye on the economic situation because obviously it is in the interest of everybody that we get full control of the situation and that we return to a path of growth for all countries involved. I think that is clearly the priority for everybody.

WILLIAMS: But the problem is how do you control foreign direct investment?

SAUVANT: Well, at the moment the issue is not so much to control foreign direct investment but how do you deal with short-term capital movements. And I think that there is not one country which is not actually trying to attract more foreign direct investment or is trying to think of imposing controls on incoming foreign direct investment. In the area of

foreign direct investment the issue is to attract foreign direct investment, not to keep it out.

WILLIAMS: And, when you compile this report do you look back sometimes to the transnational corporation when you thought it was all a bad thing?

SAUVANT: Well, you mentioned that at the beginning and you are right. Countries have changed their attitudes towards foreign direct investment and to transnational corporations and, perhaps, they have changed it too much in the sense that they expect too much from transnational corporations. The development effort remains primarily and first of all a domestic effort. Foreign direct investment can make a contribution to that.

WILLIAMS: Well, anything? Very briefly.

FARHAN: I just wanted to say in terms of what Ricardo said about Cuba, I noticed that very recently the North Korean Government purged their minister for encouraging foreign investment and up until then I didn't realize that they had one, so you must be doing a good job.

SAUVANT: Well, actually I didn't know about a purge but I understand that a large corporation from the Republic of Korea has just announced a major foreign direct investment project in North Korea.

WILLIAMS: North Korea? Well, please don't put any of my pension money there.... Mr. Sauvant that's all the time that we have. Thank you very much for being with us on this edition of **WORLD CHRONICLE.** Our guest has been Karl Sauvant from the Division on Investment Technology and Enterprise Development of the United Nations Conference on Trade and Development, UNCTAD. Mr. Sauvant is responsible for the publication of the World Investment Report which tracks the flow of international capital. He was interviewed by Ricardo Alday from the *Mexican News Agency, NOTIMEX*, and Farhan Haq from *Inter Press Service*. I'm Ian Williams sitting in for Michael Littlejohns. Thank you for joining us. We invite you to be with us for the next edition of **World Chronicle**.